No. 21,146

In the

United States Court of Appeals

for the Ninth Circuit

SECURITIES AND EXCHANGE COMMISSION, *Plaintiff-Appellant,* vs. NATIONAL SECURITIES, INC., a corporation, et al, *Defendants-Appellees.*	

Brief of Appellees

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JURISDICTION

This is an action for equitable relief filed by the Securities and Exchange Commission under Section 10(b) of the Securities Act of 1934, 15 U.S.C. Sec. 78j(b), and Rule 10b-5 of the Commission, 17 CFR Sec. 240.10b-5 (R. 1). The issues were presented to the trial court on an answer (R. 467) and motion for judgment on the pleadings (R. 474), which was granted (R. 795). The District Court has jurisdiction in cases of this type under 15 U.S.C. Sec. 78aa; jurisdiction is challenged in this particular case for want of indispensable parties, see Rule 19, Fed. R. Civ. P. This Court has jurisdiction under 28 U.S.C. Sec. 1291.

STATEMENT OF CASE

A. Introduction.

This was a suit by the SEC originally brought in 1965 to block the merger of two Arizona insurance companies. On the original complaint (R. 1) the SEC obtained an ex parte temporary restraining order (R. 108). However, the restraining order was almost entirely quashed (R. 292), eliminating all operative parts which would have affected the merger. The merger thereupon went through. The Commission then filed a supplemental complaint for an injunction (R. 423) which was duly answered (R. 467).

The defendants moved for judgment on the pleadings or in the alternative for summary judgment (R. 474), and the judgment on the pleadings was granted (see the court's discussion of the remedy, par. 2, R. 795).

Behind the 1965 merger was a 1964 stock acquisition, and each of these relates to the case.

1. STOCK ACQUISITION.

In April, 1964, a leading Arizona insurance company was National Life & Casualty Insurance Company (National Life), held to the extent of a controlling interest by a holding company, National Securities, Inc. (National Securities). A second and even larger Arizona insurance company, then wholly unconnected with National Life, was Producers Life Insurance Company (Producers). Producers administration was in the hands of a group of directors and shareholders largely known for purposes of this case as the Johnson group. National Securities bought out the Johnson group. It was a complex transaction involving over $1,500,000, and numerous separate transfers were involved (R. 71). Few of the details of the sale matter for purposes of this lawsuit.

The practical effect of the transaction when it was completed was that National Securities continued to control National Life and had a 13.2 per cent interest in Producers (R. 41). A management agreement whereby National Securities would manage Producers was promptly agreed to (R. 73).

2. THE MERGER.

The SEC says that a merger of National Life and Producers was contemplated from the beginning. National Securities says otherwise, and the relevant materials pro and con are appended in a note.* But, regardless of when

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*The inference by the SEC that the merger of National Life into Producers was intended on April 27, 1964, is unwarranted. The fact that the original intent of National Secruities was not to effect a merger between National Life and Producers is evidenced by the minutes of April 27, 1964 (R. 41-42) and by the management agreement itself, distributed to all stockholders, under which National Securities anticipated an assumption of substantially all assets of Producers and assumption of all of its liabilities; pending this result, the management agreement was executed providing for the operation of Producers (R. 73). Under this agreement National Securities guaranteed the stockholders of Producers a certain profit, as was set forth in the mailings; See R. 621. In fact, National Securities did pay certain amounts to Producers the first year under this guarantee (R. 718).

Had the original plan been followed, and had National Securities acquired all of the assets of Producers in exchange for stock, it could have well afforded to pay all amounts required to be paid under the non-compete agreements fully described elsewhere in this brief. The later agreement to cancel the management agreement was the product of dissident stockholder dissatisfaction with it; See, for allusion R. 126. In consequence of this drastic reorganization of the original plan of National Securities, National Producers agreed to reimburse National Securities for non-compete payments which National Securities would have made had not the original plan to acquire the assets of Producers been modified.

The minutes of the April 27, 1964 directors meeting read as follows:

> "He [Mr. Wallace] noted further that it was the intent of National Securities that subsequently one form or another of corporate reorganization or amalgamation be proposed to the stockholders of Producers. He stated that at the present time

the idea dawned, the two companies were merged. A.R.S. Sec. 20-731 provides that insurance companies may "merge or consolidate" by complying with the general law on that subject, which in turn requires the agreement of two-thirds of the shareholders of each corporation to agree. However, the insurance provision adds a requirement of approval by the Director of Insurance and gives him the duty of examining into the merits of the merger. The intention to merge National Life and Producers was announced prior to July, 1965 (the merger date), and the steps necessary to merge two Arizona insurance companies were followed (*e.g.*, R. 800).

Even with the tight limitations of a motion for judgment on the pleadings, this record shows that there was a very vigorous controversy within Producers as to whether or not to agree to the merger. (See, *e.g.*, the Merger Fact Book,

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> he felt it was not particularly important to determine precisely the method to be chosen so long as it was clear that the stockholders of Producers would, at the appropriate time, have proposed to them a specific plan for reorganization as a result of which they would formally join the National Securities group, and be offered the opportunity to convert their present holdings to shares of the Common Stock of National Securities." (R. 41, 42).

The actual merger of National Life into Producers did not convert the holdings of Producers stockholders into shares of Common Stock of National Securities. These holders continued as stockholders of Producers, the surviving company. The Management Agreement between National Securities and Producers also cited by the SEC as authority for its inference, provides as follows:

> "WHEREAS National [National Securities] and Producers each desire at some future date and during the term of this agreement to propose to the appropriate stockholders a corporate reorganization or amalgamation wherein and whereby National directly, or indirectly through its subsidiaries now or hereafter existing, shall acquire ownership of all the assets and assume all the liabilities of Producers;" (R. 73).

As a result of the merger the ownership of National Securities in the surviving corporation, National Producers, was approximately 36 per cent, substantially less than all the assets and all the liabilities of Producers. (R. 718).

R. 620). There was a hard-hitting proxy solicitation campaign, with much solicitation material. (R. 567 *et seq., passim.*)

After the operative portions of the SEC's ex parte restraining order were quashed by the Federal District Court, the merger was consummated by the shareholders. The favorable stockholder vote was "overwhelming," the favorable vote running over 75 per cent of all shareholders (R. 437-38, reference to par. 34 of amended complaint); the percentage of those actually voting was much higher. It was expressly approved by the Arizona Director of Insurance (R. 800). The surviving insurance company has since functioned as National Producers Life Insurance Company (National Producers).

B. This Litigation.

1. THE SUIT AND ITS CHARGES.

On March 30, 1965, the SEC filed this action and obtained an ex parte restraining order (R. 108-11), the practical effect of which was to enjoin the merger. The original parties were the National Securities group and its officers (by now including Producers and National Life) and the sellers or Johnson group. The charge was Violation of Section 10(b) of the Securities Exchange Act of 1934 (Act), and Rule 10b-5 issued under it. Section 10(b) has no independent importance for purposes of this case; it simply gives basis for the regulation. The regulation makes it unlawful to make any untrue statements or misleading omissions or employ fraudulent schemes *"in connection with the purchase or sale of any security."*

(a) Original Charges.

We thus come to the substance of the SEC's original charge:

(i) In the original sale of April, 1964, the members of the selling (Johnson) group in various ways breached their fiduciary duties to Producers (R. 6-7). The National Securities group, or purchasers (who are not suggested to have been "insiders" as to Producers), allegedly assisted in this.

(ii) The resultant merger of the two insurace companies was allegedly unfair to Producers, and the proxy solicitations for the merger did not divulge to the shareholders material facts as to the merger.

The errors and omissions asserted in the proxy solicitation (R. 9-11) are the heart of the complaint. Reduced to a sentence, the charge is that Producers was victimized in two interrelated ways: (a) By the selling group, which sold control improperly; (b) By the National Securities group, which allegedly failed to disclose certain material facts in Producers merger proxy solicitations.

We do not stop to analyze the actual underlying charges for two reasons: (a) As will be developed below, the charges against the Johnson group were dropped from the case. There has been no suggestion in this record, nor could there be, that the National Securities group has anything whatever to do with the Johnson group except that they bought what the Johnson group sold. We therefore have no occasion to speak for that group, nor reason to do so. (b) The existence or nonexistence of the alleged frauds is viewed by defendants as immaterial to the decision of the court below. We shall develop the precise issues and precise grounds for decision in a moment; they go to the scope of Rule 10b-5 and to the interrelations of the McCarran Act and the Arizona Insurance Code. Hence the question of whether the statements in the solicitations were misleading is simply immaterial; the court below did not pass on this.

We appreciate the familiar doctrine of legal gamesmanship that the equities may in truth control even technical matters of statutory interpretation. We believe that there were no fraudulent or misleading or devious statements or nonstatements of any kind. The allegations to the contrary by the SEC are totally denied in the pleadings and, we contended below, the record demonstrates the allegation to be incorrect. Nonetheless we confine that part of the discussion to a footnote in order to emphasize the defendants' main position: On the face of the complaint—on the pleadings—there is no violation of law.*

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*The Commission makes four specific complaints (Br. p. 7-8). Item 1 is an allegation that the amount involved in the assumption of noncompete agreements was not disclosed. The noncompete agreements were a well known part of the history of Producers. The fact that they were to be assumed was set forth extensively in the Consolidation Agreement (R. 85) distributed to every shareholder. While dollar figures were not used, no one needed to be in doubt about the hard facts.

The SEC's second claim is that there was an improper projection of profits for 1965. This projection of $460,000 was in fact reasonable when made, having been based on 1963 income. 1966 profits, though not in this record, were about $220,000. Moreover, the charge overlooks the fact that the whole picture was presented; for example, annual figures from 1959-1963, showing profits and losses, for both companies, were given to the shareholders; see *e.g.,* R. 137.

The third complaint is that certain treasury stock was assigned an asset value and National Securities believes the valuation to have been based on sound accounting principles. The fourth contention relates to the accounting treatment of certain shares of Producers in a report to the Arizona Director of Insurance. This wholly overlooks the special requirements for insurance accounting and the fact that this particular treatment was expressly approved by the Arizona Director (R. 477).

The thinness of these charges as contained in its present Brief is confirmation of their afterthought quality. The actual temporary restraining order originally obtained in this case, and filed with the original complaint, is based upon a thirty-paragraph affidavit of W. Stevens Tucker, which at R. 30-32 (par. 25-29) itemizes the dissatisfactions of the SEC with the proxy solicitation. *Not a single one of the four points which the Commission brings to this Court was in fact included in the Tucker affidavit,* which between courts seeks to change ground altogether.

(b) A Subsequent Charge.

On April 27, 1964, when the purchase was made by the National Securities group, it bought certain treasury stock from Producers as an incident of the whole transaction. It paid for that stock partly in cash and partly by the assumption of certain previous obligations of Producers known as the Pound noncompete agreements (R. 60). It did on the same day enter into a management agreement with Producers whereby managerial functions of Producers would be undertaken by National Securities (R. 73).

In the later Consolidation Agreement of National Life and Producers, the Pound noncompete agreements were assumed by National Producers. The management contract, and with it the possible benefits thereunder to National Securities, was cancelled (R. 79).

In its original complaint in this action, the SEC alleged that on April 27, at the time of the transaction, National Securities and National Life intended to cause Producers Life and National Life, after a merger or consolidation, to reimburse National Securities for the moneys involved in the Pound noncompete agreements (par. 6, R. 6). In the amended complaint, this same allegation was carried forward (par. 5, R. 428).

Neither complaint asks any specific relief directed at any contention that there was somehow something wrong about this series of events. No argument based on the paragraphs just identified was offered to the District Court; this claim is simply not mentioned.* In its brief to this Court, the Commission argues (R. 28-30) that the failure of National Securities to advise Producers when it was making this purchase on April 27, 1964, of some alleged intent in respect

*To avoid duplication, we reserve discussion of the assignments of error on this point for the Agreement.

to the Pound noncompete agreements, is a violation of Rule 10b-5.

2. THE PROCEEDINGS BELOW: FROM TEMPORARY RESTRAINING ORDER TO AMENDED PLEADINGS.

The National Securities defendants answered on April 15, 1965 (R. 170-78). They denied any jurisdiction on the matter and also denied all allegations of misdeeds.

The matter came on before Judge Mathes sitting in Phoenix. On April 16, 1965, he granted a motion to drop the Johnson group from the case (R. 291) without prejudice to the Commission's right later to move to plead them in again.

On motion of the National Securities group, the court deleted from the temporary restraining order all the general language, eliminating every part which would have precluded the merger (Order, R. 292). The SEC did not move for any stay of this cancellation of the operative portions of the temporary restraining order nor did it apply to this Court for any relief. In those circumstances, as already noted, the merger was voted by the shareholders, was approved by the Director of Insurance, and became effective.

The matter came up again before Judge Mathes in July of 1965 in San Francisco. Cross application for orders of complete dismissal of the case by the defendants and for further proceedings on the application for preliminary injunction by the SEC were put aside, the court simply giving the Commission 30 days within which to file an amended and supplemental complaint if it desired to do so (R. 419-21).*

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*We do not have the transcript of this proceedings and therefore can only avow that Judge Mathes in essence gave the Commission its choice of having the case dismissed at that time or of amending to show the merger so that on appeal to this Court the Commission could present the actual situation. This is detailed in defendants' summary of the events, R. 507-08, which is no way controverted.

Thereafter, on August 1, 1965, the SEC filed its amended and supplemental complaint for injunction (R. 423). The two most substantial differences between this 20-page document and its predecessor were:

(a) This complaint did not include as defendants any members of the Johnson group. Nonetheless it alleged that those nonparty persons had proceeded in contravention of their fiduciary duties by selling to the National Securities group (R. 430).* The complaint is shot through with allegations concerning "the selling directors" and the complaint expressly prays that the acts of the defendants "in concert with the selling directors" be declared to be illegal (R. 425, 427). The court is asked to declare fraudulent the contracts between the Johnson group and the defendants (R. 440).†

(b) The merger having been accomplished, it could no longer be enjoined; the prayer for relief in essence calls upon the defendants to undo it.

3. THE PROCEEDINGS BELOW: PARTIES.

Since the amended complaint called upon the court to declare illegal transactions of persons not parties to the cause,

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*"12. The selling directors, in carrying out and executing the transactions described above, and thereby enriching themselves, were acting in concert with the defendants and in contravention of their fiduciary obligations to the stockholders of Producers Life as a group, and such selling directors knew or should have known that the defendants were engaged in accomplishing a device and scheme to effect a merger or consolidation of Producers Life and National Life for the benefit and advantage of National Securities or to accomplish some other similar arrangement for the benefit and advantage of National Securities." (R. 430)

†"1. That the Court determine and adjudicate that the occurrences described in Section III above constituted a device, scheme and artifice to defraud and a series of acts, practices and a course of business, in connection with the purchase and sale of securities, which were accomplished by the defendants in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 17 CFR 240.10b-5." (R. 440)

the answer of the National Securities defendants expressly raised the absence of indispensable parties (R. 467). Apparently in recognition of at least some force to this challenge, the Commission moved to add the Johnson group (R. 494), by way of a tender of a second amended complaint (R. 498). The National Securities group opposed this motion (R. 507-09) on the ground that it came too late. These defendants contended that the court, in permitting the Commission to amend at all, was simply giving it leave to show the actual fact of the merger so that it might appeal, if it desired to do so, on the basis of the actual facts. Defendants contended that this privilege had been abused by "a whole series of new allegations directed not at National Securities but at the Johnson group." The National Securities group thus objected not only on the ground of want of indispensable parties but also on the ground that the SEC was not entitled to so many afterthoughts, and thus that the cause should be wound up.

4. THE PROCEEDINGS BELOW: ISSUES AND THE DECISION AS TO EACH.

National Securities presented several separate and independent grounds for judgment on the pleadings. The positions of the parties and the rulings of the court as to each are as follows:

(a) There can be a violation of Rule 10b-5 only where a "purchase or sale" of securities is involved. The defendants argued that a statutory merger of two insurance companies, even where certificates are exchanged, is not a "purchase or sale" as that term is used in the statute. The court below was not decisive on this point, although the import of its holding appears to be that this is not a "purchase or sale" case at all (Finding 7, R. 798).

(b) This is an action brought under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. A wholly different rule, Section 14 in the same Act and Rule 14(a)(9),

deal with proxy solicitation. The proxy solicitation rule clearly did not apply to these insurance companies under the law as it stood at the time of all relevant events. Amendments to the law might have made proxy requirements applicable later, but not in 1965. The defendants contended that the SEC was attempting to anticipate in this action legislation not yet operative. The trial court agreed and so held (Findings 4, 5 and 6, R. 797-98).*

(c) The McCarran Act provides that "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, . . ." (15 U.S.C. Sec. 1012(b)). Arizona law fully governs the merger of insurance companies, putting the duty of authorizing such mergers upon the Arizona Director of Insurance, subject to a right of appeal to Arizona courts. Here the Director had approved and there had been no appeal. Defendants contended that the effort of the SEC to invalidate a merger of two Arizona insurance companies would "impair" or "invalidate" or "supersede" Arizona state laws regulating the insurance business. The trial court agreed and held that the SEC's claim was barred by the McCarran Act (Findings 7-12, R. 798-800).

(d) The defendants contended that the relief sought was beyond the scope of that permitted under the statute, and the trial court agreed (Finding 13, R. 800-01).

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*Finding No. 5 is as follows: "5. Not until sometime during 1966 will the coverage of § 14 be extended, by virtue of the act of August 20, 1964 [78 Stat 569], to any corporation similarly situated to the insurance companies involved in this action; and then only if not exempted by new § 12(g)(2)(G) of the 1934 Act [15 U.S.C. § 78(1)(g)(2)(G)] which excludes 'any security issued by an insurance company' provided the insurance company is subject to certain defined State regulation;"

On the basis of the foregoing considerations, the trial court entered its judgment that the allegations in the pleadings failed to state a claim for which relief could be granted (R. 804). There were, however, other matters.

(e) The trial court denied the motion for leave to add additional parties (R. 793-94). It did not rest that conclusion upon the grounds of lateness which had been advanced by the defendants, set forth above, but rather held that on the merits no claim within the federal jurisdiction in an action could be brought by the SEC against those defendants (R. 793-94).

(f) The defendants claimed that there was no showing of the necessary causal connection between any alleged complaints about the purchase in 1964 and the merger in 1965. The trial court did not deal with this subject.

(g) The defendants contended that there had been no breach of fiduciary duty by them, that there were no improper proxy solicitations, and that there had been no breach of duty of any kind. Since the trial court concluded that no matter was alleged as to which relief could be granted, none of these contentions had to be passed on.

(h) No reference was made to the SEC's argument in this Court relating to treasury stock because this argument had not been made below.

C. This Appeal.

The final judgment of the District Court was March 14, 1966 (R. 804). The time to file a record on appeal was twice extended by the Federal District Court (R. 809-10), running to July 26, 1966. The SEC did not appeal from the order of the trial court denying it the right to add the Johnson group, appealing only from the judgment of dismissal; see its Specification of Errors, Brief, p. 9; its Statement of Points (R. 820) and the Commission's Brief in this Court,

p. 3, n. 2. The Commission was given until February 7, 1967, to file its opening Brief (see Special Order of Judge Chambers) and the case was referred to the April, 1967, calendar of this Court.

SUMMARY OF ARGUMENT

Taking the case as it stands on the pleadings, no violation of law is alleged. There is a preliminary jurisdictional question. The essence of the complaint is that a selling group and a buying group, in connection with the transaction between them, perpetrated some kind of a fraud. The complaint which was before the court below expressly called upon that court to find the sale and purchase fraudulent and illegal.

The members of the selling group, whose contract is thus attacked, are not before the court as parties. When the issue of indispensable parties was raised below, the Commission unsuccessfully sought to join them, and the Commission has not appealed the ruling denying them the right to do so. The selling parties are indispensable and the case must be dismissed on this ground; *State of Washington v. United States,* 87 F.2d 421 (9th Cir. 1936); *Hudson v. Newell,* 172 F.2d 848, 852 (5th Cir. 1949); *Young v. Powell,* 179 F.2d 147 (5th Cir. 1950); and see also *Interstate Commerce Commission v. Blue Diamond Prod. Co.,* 192 F.2d 43 (8th Cir. 1951).

The merger here attacked was accomplished under the Arizona statutes concerning the merger of insurance companies. The merger was expressly approved by the Arizona Director of Insurance. The SEC now asks the Federal Court to nullify the merger which was approved by the proper State authorities. Such an action would at least impair, if not invalidate or supersede, laws passed by the State of Arizona for the purpose of regulating the business of in-

surance, and this violates the McCarran Act, 15 U.S.C. Sections 1011-1015. The precise and detailed ways in which the order sought by the SEC would supersede State law are set forth in the Brief.

A statutory merger of two companies is not within the scope of Rule 10b-5 at all because that section applies only to the "purchase or sale" of securities. This underlying substantive question was decided by this Circuit in favor of the proposition that a merger is not a purchase or sale in *National Supply Co. v. Leland Stanford, Jr. University*, 134 F.2d 689 (9th Cir. 1943), *cert. denied*, 320 U.S. 773 (1943). In this case the Commission asks that "This court overrule or severely delimit" the *National Supply Co.* decision.

We believe that this Court should stand by its earlier decision. The suggestion that it be overruled comes with particular ill-grace from the Commission which, in that case, had recommended that the Court reach precisely the result which it did. The *National Supply Co.* decision has been followed by lower courts. It has been on the books for more than twenty years as the leading case on this exact point and Congress has never seen fit to alter it, nor, for that matter, has the Commission ever asked it to do so. The decision of this Court was in accordance with the facts. There is no "purchase or sale" in connection with a statutory merger but simply a conversion of stock in the merged company into stock of the surviving company. The cases are fully considered in the brief following.

Wholly apart from the fact that the merger is not a purchase or sale and so is not governed by Rule 10b-5, the prime complaint of the SEC is of alleged misleading proxy materials used in connection with the merger. But Rule 10b-5 does not deal with proxy solicitations at all. Proxy solicita-

tions are governed by a wholly different section and a wholly different rule. Subsequent to the transactions involved here, Congress adopted and made effective amendments to that other section which at least might have the effect of controlling proxy solicitations in a case such as this one; but all of this is subsequent to the instant transaction. As the trial court stated, "The Commission is seeking to get a one-year jump on the recent statute by doing now precisely what it will be authorized to do" later. In the brief following, we contend to the Court that the cases hold that Rule 10b-5 does not apply to proxy solicitations at all. We also contend that the failure of the Commission to appeal or assign as error this portion of the decision of the court below, which it has not even briefed in this Court, leaves an independent ground for decision which, apart from any other consideration, would require affirmance of the trial court.

A contention is made by the Commission for the first time in this Court that the purchase of certain treasury stock is a violation of Rule 10b-5. This matter was not presented below, there is no decision concerning it, and appellees contend that the argument comes too late. And they contend further that in any case, it is without merit.

This is basically an action to nullify a merger. Appellees contend that there is no authority to nullify a merger in a suit brought by the SEC under Rule 10b-5.

ARGUMENT

I. Introduction.

Two Arizona insurance companies merged in 1965. The SEC instituted an action to enjoin the merger, but, unable to hold the ex parte temporary restraining order with which the suit began, the Commission took no other action to pre-

vent the merger before it was consummated. The Commission did not apply to this Court for a stay or enter an appearance before the Arizona Director of Insurance or use any other State remedies. The merger followed a very vigorous proxy fight in which all issues were completely ventilated, and the plan was adopted by a very heavy majority of the stockholders. It was approved by the Director of Insurance of Arizona, the officer charged with review of such matters.

We submit that the judgment of the trial court should be affirmed and that this matter should be put at rest.

II. The Suit Must Be Dismissed for Want of Indispensable Parties.

The point is simple but decisive. The Johnson group is indispensable in this action.

1. The original action included as defendants the sellers of Producers' stock (the Johnson group) and the buyers of it (the National Securities group). But the relief sought in that action, as originally filed, did not directly challenge the contractual relations between the parties; it aimed primarily forward, seeking to enjoin the merger. In these circumstances, the trial court saw fit to drop the Johnson group as defendants on their motion (R. 291).

2. But the amended complaint was very different. The amended complaint added a paragraph 12 (R. 430), set out verbatim in the Statement of Facts, expressly alleging that "the selling directors" were acting in contravention of fiduciary obligations and that they knew or should have known that the defendants were doing some improper act. Paragraph 1 of the prayer for relief in the amended complaint, also quoted above, expressly asks the court to determine that the various "occurrences," which is to say the contractual pattern between the Johnson group and the defendants, were illegal (R. 440).

The defendants forthwith pleaded a want of indispensable parties (R. 467). The SEC then offered a second amended complaint, seeking to cure the want of these parties by adding them (R. 494); but this the trial court refused to permit (R. 793), all as is more fully set forth in the Statement of Facts. There has been no appeal from this ruling. It is not specified as error, and the Commission's motion to add these parties in response to our insistence on their indispensability must be regarded as abandoned here; 9th Cir. R. 18(2)(d), 28 U.S.C.A.; *Dower v. United Airlines, Inc.,* 329 F.2d 684 (9th Cir. 1964); *Everest & Jenings, Inc. v. E and J Mfg. Co.,* 263 F.2d 254 (9th Cir. 1959), *cert. denied,* 360 U.S. 902 (1959). This is not controverted by the Commission, which acknowledges that it has not appealed the parties' ruling. It is therefore settled that these parties may not be added, and the remaining question becomes whether there is any jurisdiction without them.

The Court must therefore confront the question of indispensability. It is asked to review agreements between the Johnson group and the National Securities group and to declare them fraudulent and illegal—in an action in which the Johnson group is not joined. Put another way, those who bought are to be charged with illegality for their purchase, while those who sold are left untouched. This conflicts altogether with the familiar requirement that parties must be joined where this is required by "equity and good conscience," *Shields v. Barrow,* 58 U.S. (17 How.) 130, 15 L.Ed 158 (1855); *State of Washington v. United States,* 87 F.2d 421 (9th Cir. 1936).

We deal with that section of the law of indispensable parties which may be called the "one end of a contract" cases. In the base situation, A and B make a contract. C wishes to challenge the validity of that contract and sues A.

B is an indispensable party. The basic rule, *Hudson v. Newell,* 172 F.2d 848, 852 (5th Cir. 1949), followed in *Young v. Powell,* 179 F.2d 147, 151-52 (5th Cir. 1950), is "We know of no exception to the rule that an instrument cannot be destroyed totally by a decree unless all parties to it, or their successors in interest, are before the court." Certainly the general rule is that "rescission of a contract, or declaration of its invalidity, as to some of the parties, but not as to others, is not generally permitted." *Ward v. Deavers,* 203 F.2d 72, 75 (D.C. Cir. 1953). See the closely related case of *Rader v. Manufacturers Casualty Ins. Co.,* 242 F.2d 419, 428 (2d Cir. 1957); and see *Halpern v. Pennsylvania Ry.,* 189 F. Supp. 494, 498 (E.D.N.Y. 1960); *Stenhouse v. Jacobson,* 193 F.Supp. 694, 696 (N.D. Cal. 1961); and for the problem of enforcement of a disputed contract, *Kleinschmidt v. Kleinschmidt Lab.,* 89 F.Supp. 869 (N.D. Ill. 1950). The matter is closely analogous to *Sawyer v. Pioneer Mill Co.,* 300 F.2d 200, 202 (9th Cir. 1962), a suit originally brought to enjoin use of proxies at a merger meeting. The proxies were used, and the merger voted, whereupon plaintiff sought to amend to demand rescission of the merger. This Court, in holding the case moot, made observations highly in point in this case:

> "The idea of a rescission of the merger is obviously an afterthought of appeallant or her counsel. American, the other party to the merger, was not named as a defendant, nor did appellant ask leave to join it. Obviously, it was a necessary party in any attempt to prevent the merger, and it is difficult to believe that its omission was inadvertent. In short, since the purpose was to prevent the meeting, or the use of the proxies at the meeting, since both of those things have happened, and since the present action is not an appropriate vehicle for an attack upon the merger, the action has become moot."

Interstate Commerce Commission v. Blue Diamond Prod. Co., 192 F.2d 43 (8th Cir. 1951), is very close to the instant case. The government sought to enjoin defendant shipper from causing certain motor carriers to haul for it. The injunction, if granted, would keep the defendant from honoring contracts with those carriers on the ground that the contracts were illegal. *Held,* not merely the shipper who was purchasing the service, but also the carrier who was selling it, must be joined in the suit. On the ground that the matter could not be determined without affecting the interest of the absent parties or leaving the interest of those before the court "in a situation that might be embarrassing and inconsistent with equity." the court said, 192 F.2d at 47:

> "These parties have such an interest in the controversy that a final decree cannot, we think, be made without affecting that interest, or, as said by the Supreme Court, 'leaving the controversy in such a condition that its final termination may be wholly inconsistent with equity.' An injunction here against the defendant could only be granted on the theory that the various leases and contracts are void. Certainly these parties have a very substantial interest in that question and we conclude that they are indispensable parties."

The matter really is this simple. Whether the trial court was right or wrong in dropping the Johnson group on the original complaint, the SEC saw fit to amend its complaint so as clearly to involve the sellers. It deliberately added very express allegations that the Johnson group was guilty of breach of fiduciary duty, and deliberately recast the prayer for relief to call for an adjudication that the agreements between the Johnson group and these defendants were illegal. The defendants, in the light of the new pleadings, promptly raised the issue of indispensability and the Commission thereupon moved to cure its own error by add-

ing the absent parties. The Johnson group are clearly indispensable parties; they are not here; and that should be an end to the matter.

III. The Trial Court Correctly Held This Action Barred by the McCarran Act.

15 U.S.C. Sec. 1012(b) (The McCarran Act) provides that "no Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance." A.R.S. Sec. 20-731, a part of the comprehensive insurance law of Arizona, expressly regulates mergers or consolidations of insurance companies, giving the Director of Insurance the duty of approving mergers and, in the course of it, requiring him to determine whether mergers are contrary to law or are "inequitable to the stockholders of any domestic insurer involved." The determination of the Director is appealable to the State courts.

In these circumstances, the District Court held:

> "12. The allegations of the Amended and Supplemental Complaint at bar, if taken to be true, are insufficient to warrant issuance of an injunction against future violations of § 10(b) and Rule 10b-5, since the requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance pursuant to A.R.S. § 20-731, would at least 'impair,' if not 'invalidate' or 'supersede,' laws enacted by the State of Arizona 'for the purpose of regulating the business of insurance,' within the meaning of the applicable provisions of the McCarran Act [15 U.S.C. § 1012(b)];" (R. 800)

A. THE McCARRAN ACT BARS FEDERAL SUPERSESSION OF STATE INSURANCE LAWS.

The spirit of the McCarran Act is recognized in the majority opinion in *Securities and Exchange Commission v.*

Variable Annuity Ins. Co., 359 U.S. 65, 79 Sup.Ct. 618, 3 L.Ed 2d 640 (1959), in which Justice Douglas for the Court said:

> "We start with a reluctance to disturb the state regulatory schemes that are in actual effect, either by displacing them or by superimposing federal requirements on transactions that are tailored to meet state requirements. When the States speak in the field of 'insurance,' they speak with the authority of a long tradition. For the regulation of 'insurance,' though within the ambit of federal power, (*United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, 64 S.Ct. 1162, 88 L.Ed 1440), has traditionally been under the control of the States." 359 U.S. at 68-69, 79 Sup. Ct. at 620.

The legislative history is developed in the dissenting opinion in that same case in language which we think a majority would equally accept, see 359 U.S. 65, at 99, as follows:

> "In 1944, this Court removed the supposed constitutional basis for exemption of insurance by holding, in United States v. South-Eastern Underwriters Ass'n, supra, that the business of insurance was subject to federal regulation under the commerce power. Congress was quick to respond. It forthwith enacted the McCarran Act, 59 Stat. 33, 15 U.S.C. §§ 1011-1015, 15 U.S.C.A. §§ 1011-1015, which on its face demonstrates the purpose 'broadly to give support to the existing and future state systems for regulating and taxing the business of insurance.' Prudential Insurance Co. v. Benjamin, supra, 328 U.S. at page 429, 66 S.Ct. at page 1155, and 'to assure that existing state power to regulate insurance would continue.' Wilburn Board Co. v. Fireman's Fund Ins. Co., supra, 348 U.S. at page 319, 75 S.Ct. at page 373. Thus rather than encouraging Congress to enter the field of insurance, the South-Eastern decision spurred reiteration of its undeviating policy of abstention."

In the case of *North Little Rock Transp. Co. v. Casualty Reciprocal Exch.*, 181 F.2d 174 (8th Cir. 1950), an Arkansas statute authorized the licensing of rating bureaus and provided for the establishment by them of casualty insurance rates to be charged by their members and subscribers. The plaintiff in this case, a taxicab company, sought relief from its insurance rate by an action brought under the Sherman Anti-Trust Act. The defendants denied that they had violated the Sherman Act and asserted that the conduct of which the plaintiff complained was regulated by the laws of Arkansas and under the McCarran Act could not be reached by the Sherman Act. The Court of Appeals held that unless the Arkansas Supreme Court ruled its statute unconstitutional, the federal courts were required to give credence to the Arkansas statute rather than the Sherman Act. Said the court:

> "The purpose of the McCarran Act was to permit the States to continue the regulation of the business of insurance, unhampered, to the extent provided by the Act, by feredal legislation relating to interstate commerce." *Id.* at 176.

In the case of *California League of Independent Ins. Producers v. Aetna Casualty, et al.*, 175 F.Supp. 857 (N.D. Cal. 1959), a California statute authorized cooperation between insurers for rate making and other related matters. Pursuant to that statute, the major insurance companies in California, in setting their rates, agreed to decrease the rate of commission paid to insurance agents. The insurance agents through their organization sued for treble damages under the Sherman Act. The court ruled that California had regulated the business of insurance within the meaning of the McCarran Act, and that by compliance with the McCarran Act, had deprived the Sherman Act of any validity in that area. Said the court:

> "This court is of the opinion that a State regulates the business of insurance within the meaning of § 1012 (b) when a State statute generally proscribes (*F.T.C. v. National Cas. Co.,* 1958, 357 US 560, 78 S.Ct. 1260, 2 L.Ed.2d 1540) or permits or authorizes certain conduct on the part of the insurance companies. In *F.T.C. v. National Cas. Co.,* supra, the Court held that there was State regulation within the meaning of Sec. 1012 (b) when a State act *generally* prohibited 'certain standards of conduct.' 357 U.S. at page 564, 78 S.Ct. at page 1262. From the above case it would seem to follow that if a State has generally authorized or permitted certain standards of conduct, it is regulating the business of insurance under the McCarran Act." *Id.* at 860.

In the case of *Zachman v. Erwin,* 186 F.Supp. 691 (S.D. Texas 1960), plaintiffs brought an action for rescission of the purchase of securities of an insurance business under the Securities Act of 1933. The court held the McCarran Act applicable to an action under the Securities Act, but held that in this particular case there was no Texas statute which could be invalidated. The case is important, however, because the court said:

> "That statute does not preclude application of the Securities Act to the insurance business since there is no indication that it invalidates, impairs, or supersedes any law of the State of Texas regulating the insurance business. An examination of the Insurance Code of Texas reveals no special remedy for purchasers against persons who have defrauded them in the sale of insurance company securities." *Id.* at 694.

By implication, of course, if there had been a Texas statute being superseded by the application of the Securities Act, the decision of the Court obviously would have been the opposite. In our case, as is developed below, we

·learly have Arizona statutes authorizing action by the)irector of Insurance which would be superseded and in-ralidated and impaired by the application of the relevant tatutes.

In the case of *Federal Trade Commission v. National Casualty Co.,* 357 U.S. 560, 78 Sup.Ct. 1260, 2 L.Ed.2d 1540 1958), the Supreme Court held that with respect to ad-ertising which was prepared and shipped in bulk to in-urance company agents, for local distribution, regulation of advertising was within the means of regulation of the arious states, and that the Federal Trade Commission ad no authority. The Federal Trade Commission argued hat, even conceding the validity of the McCarran Act as imiting the jurisdiction of the Federal Trade Commission, State regulation of these practices was not sufficient to ring the McCarran Act into operation. Said the Court:

> "Petitioner does not argue that the statutory provisions here under review were mere pretense. Rather, it urges that a general prohibition designed to guarantee certain standards of conduct is too 'inchoate' to be 'regulation' until that prohibition has been crystallized into 'administrative elaboration of these standards and application in individual cases.' However, assuming that there is some difference in the McCarran-Ferguson Act between 'legislation' and 'regulation,' nothing in the language of that Act or within its legislative history supports the distinctions drawn by petitioner." 357 U.S. at 564, 78 Sup.Ct. at 1262.

In the instant case, the Commission argues that the "sale of stock of insurance companies" is not exempted from 'ederal control by the McCarran Act. It relies on two cases, *Securities and Exchange Commission v. American Founders Life Ins. Co.* (Civ. No. 6021, D. Colo. 1958), and *United States v. Meade,* 179 F.Supp. 868 (S.D. Ind. 1960). The 'ormer case apparently is unreported, and we cannot com-

ment as to it. The *Meade* case held that the particular company was not engaged in any relevant fashion in the "business of insurance" at all. See 179 F.Supp. at 876.

But this talk drags a red herring into the case. We are not dealing with the sale of stock or anything else which is tangential or remote from the central function of insurance regulation. In the instant case the ultimate question to be determined by someone is the absolute bedrock question of the existence of an insurance company. Here these two Arizona insurance companies could merge and become one Arizona insurance company or they could not. The determination of this question is at the very heart of the state regulatory function.

As the Fourth Circuit has recently said, "Unless a Federal statute is made specifically applicable to the insurance business, it shall not 'invalidate, impair or supersede' any State insurance law." *Allstate Ins. Co. v. Lanier,* 361 F.2d 870 (4th Cir. 1966). The guiding principle is that "Where there is an applicable state statute, the federal Legislation does not apply." *Transnational Ins. Co. v. Rosenlund,* 261 F.Supp. 12, 26 (D. Ore. 1966).

B. THE ATTEMPTED APPLICATION OF FEDERAL LAW WOULD SUPERSEDE STATE LAW.

The McCarran Act may permit supplemental or ancillary or additional Federal regulation which somehow relates to insurance; an illustration is *United States v. Sylvanus,* 192 F.2d 96 (7th Cir. 1961), a mail fraud case. What it prohibits is federal acts which "invalidate, impair or supersede" State laws regulating insurance. This is precisely the instant case.

1. The underlying transaction occurred on April 27, 1964. According to paragraph 13 of the complaint (R. 430), "as a further incident of said scheme and plan," a manage-

ment agreement was entered into on that date between Producers Life and National Securities by which National Securities "assumed full and complete management of the business and affairs of Producers Life."

This management agreement was expressly approved in writing by the Director of Insurance of Arizona after full consideration, in accordance with A.R.S. Sec. 20-727. The Arizona statute expressly provides that the director should disapprove of any such contract if he finds that it:

> "1. Subjects the insurer to excessive charges.
>
> "2. Is to extend for an unreasonable length of time.
>
> "3. Does not contain fair and adequate standards of performance.
>
> "4. Contains other inequitable provisions or provisions which impair the proper interests of stockholders or members of the insurer."

The Arizona Director of Insurance presumably found that the management agreement was fair in its charges, was not too long in its period of operation, was fair and adequate in its standards of performance, and contained no other inequitable provisions which would impair the proper interests of stockholders of Producers. We thus find the Commission asking this court to accept as an "incident of said scheme and plan" the precise matter which has been found to be wholly appropriate under Arizona law by the Arizona authority charged with this duty.

2. The complaint complains that the shares of Producers Life which were acquired by National Securities were transferred to National Life. This investment of over a million dollars by National Life was also expressly approved, in writing, by the Director of Insurance as required by A.R.S. Secs. 20-535 and 536.

3. This action purports to be brought under Commission Rule 10b-5, the first point of which makes it improper "to employ any device, scheme, or artifice to defraud." The precise "artifice" being enjoined is a merger. Yet A.R.S. Sec. 20-731 B. expressly provides that any merger must be submitted to the Director of Insurance to determine whether it is "contrary to law" or "inequitable to the stockholders of any domestic insurer involved." In addition there are other criteria but this is enough—the Commission complains that there is a plan resulting from a breach of fiduciary duty which is unfair to the other shareholders of Producers. This *exact* matter must come on for a decision by the Arizona Director of Insurance before the merger can become final. It would be an impossibility to supersede his function more completely than does this injunction—that function is totally obliterated.

4. Rule 10b-5 makes it illegal "to make any untrue statement of a material fact or to omit to state any material fact necessary" to deal fairly with the subject matter. A.R.S. Sec. 20-447 expressly prohibits the making or distribution of false statements on finances, again the general substance of precisely what is being complained of by the Commission.

5. The provision just noted is part of Article 6 of the Arizona Insurance Code which is headed "Unfair Practices and Frauds." This article begins with A.R.S. Sec. 20-441 which declares Arizona's express and precise purpose of meeting the responsibilities of the McCarran Act by providing state regulation for those matters which should be thus regulated. A.R.S. Sec. 20-441 is as follows:

> "Among the purposes of this article is the regulation of trade practices in the business of insurance in accordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945, 59 Stat. 33, by

> defining, or providing for the determination of, all such practices in this state which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined."

Nor is this merely a pious prayer. As to the vital matter of the merger, the duty of approval or disapproval lies squarely on the Director of Insurance as has been noted. A.R.S. Sec. 20-142 gives him full investigative authority. The very remedy of injunction itself is expressly provided by A.R.S. Sec. 20-152 "if the Director has cause to believe that any person is violating or is about to violate a provision of this title."*

IV. The Merger Is Not a "Purchase or Sale" for Purposes of Rule 10b-5.

The transaction which the SEC originally sought to enjoin and which it now seeks to undo is the merger of two insurance companies, Producers and National Life. The complaint alleges fraud and the answer denies anything of the sort, but whichever party is right, unless a statutory merger is a "purchase or sale" within the meaning of Rule 10b-5, that section has no application to the instant case at all.

The question has been decided by this Court in favor of the position of appellees in *National Supply Co. v. Leland Stanford, Jr. University,* 134 F.2d 689 (9th Cir. 1943), *cert. denied,* 320 U.S. 773 (1943). The SEC has advised this Court in this case that it "will seek to have this Court over-

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*Whether these matters will be within the scope of the Commission's jurisdiction under the 1964 amendments to the 1934 Act is a problem for the future; Section 12(g)(1)(G), 15 U.S.C. Sec. 78*l*(g)(1)(G) makes this depend upon whether the states have special legislation.

rule or severely delimit a determination previously made by it" in the *National Supply Company* case.*

Judge Mathes did not squarely decide this matter since there were abundant other grounds for his conclusion. The relevant language of his order on this point is in the note.†

A. A STATUTORY MERGER IN ARIZONA IS IN FACT NOT A PURCHASE OR SALE.

We begin with precisely what it was that the parties were doing. The consolidation or merger plan presented for the vote for which proxies were solicited, is at R. 79-87. At that time, Producers had about 881,000 shares of stock outstanding and National Life had about 1,018,000 outstanding, each with a par value of one dollar. "The principal purpose of this Agreement is to provide for the merger of National Life into Producers, which will continue as the surviving corporation, governed by the laws of the State of Arizona." (R. 80) The parties agreed to submit their plan to the

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*In the Commission's opening brief on the merits, the "no sale" matter is discussed, pp. 22-28. The passage concerning the request to "overrule or severely limit" the earlier case is from page 2 of the Affidavit of Newman in support of the motion of the Commission for enlargement of time, dated December 29, 1966.

†"Even if it be assumed that § 10(b) would otherwise be applicable to proxy solicitations [but see *Borak v. J. I. Case Co.*, unreported in the District Court, 317 F.2d 838, 846-847 (7th Cir. 1963), aff'd on other grounds, *sub nom. J. I. Case Co. v. Borak*, 377 U.S. 426 (1964)], and that a shareholder-approved corporate consolidation and reorganization is a "purchase or sale" of securities within the meaning of § 10(b) and Rule 10b-5 [*compare H. L. Green Co. v. Childree*, 185 F.Supp. 95 (S.D.N.Y. 1960), *and Voege v. American Sumatra Tobacco Corp.*, CCH Federal Security Law Reports ¶ 91,571 (D.Dela. 1965), *with National Supply Co. v. Leland Stanford, Jr. University*, 134 F.2d 689 (9th Cir. 1943), *and Sawyer v. Pioneer Mill Co.*, 190 F.Supp. 21 (D.Hawaii 1960), remanded 300 F.2d 200 (9th Cir. 1962), cert. den., 371 U.S. 814 (1962)], there still remains the question of whether the McCarran Act (59 Stat. 33, 15 U.S.C. §§ 1011-1015) does not preclude the application in this case of § 10(b), as implemented by Rule 10b-5;"

Director of Insurance and to the stockholders (R. 80). National Producers, as the surviving corporation, was to have an authorized capitalization of $2,500,000 divided into 5,000,000 shares of common capital stock.

We next reach the actual matter of stock transfer. Paragraph 12 of the Agreement covers the "manner of converting the shares and assets of National Life." Producers was to "issue and deliver to the stockholders of National Life" a share of Producers stock for each share of National Life stock. If a National Life stockholder for whatever reason simply kept his National Life stock, the same paragraph provided that he should be regarded "for all corporate and legal purposes, to be the owner of that number of National Producers shares." (R. 81).

That is it. Prior to the merger, each shareholder had a certain number of shares of stock of Producers and after it, he had the equivalent in shares of National Producers. Before the merger, each shareholder of National Life had National Life shares, and after the merger, he had the same number of National Producers Life shares.*

The plan and the actuality were closely guided by the Arizona Code. A.R.S. Sec. 10-341, *et seq.*, covers mergers. Two corporations "may be consolidated"; they do so by making an agreement which covers how to convert the shares and assets of the retiring corporation. Notices are required and then "the agreement of the Boards of Directors to consolidate" is submitted to the shareholders. The vote, for which solicitation of proxies is expressly authorized, is whether to adopt or reject the consolidation plan. The

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*To avoid converting the National Life shares into fractional shares by a fractional merger ratio, all Producers shareholders were given a 20 percent stock dividend. See paragraph 16 of the Consolidation Agreement, R. 79, 82.

merger is legally effective upon the ratification of the agreement by each of the corporations, and there is no requirement that the shares even be turned in or replaced. Dissenting stockholders may elect to be paid in cash for their shares. The Insurance Code adds to these requirements the approval by the Director of Insurance.

The point of this recital is that the transaction is a straight conversion. There is no purchase or sale about it. A consolidation agreement either is or is not approved by the shareholders. If it is approved, then the National Life shareholders may, if they wish, turn in their old certificates and get new certificates, but no one buys, no one sells. If they do not wish to turn the old certificates in, they need not do so—the operative legal effect is all the same by virtue of simple conversion occurring from the act of approval of the agreement itself. The shareholder has the option, if he wishes, of getting a new certificate to represent the stock he actually holds. Any shareholder at any given point has two separable interests, the one his actual interest or ownership of his fraction of the corporation, and the other his piece of paper which is evidence of that ownership. The shareholder's actual interest is changed by the vote on the consolidation agreement and the resultant filings and approvals, and this without the faintest semblance of anyone selling or purchasing anything. All that happens thereafter is the exchange of pieces of paper recognizing this interest.

B. AS A MATTER OF LAW, A STATUTORY MERGER IS NOT A "PURCHASE OR SALE."

The instant transaction is a pure statutory merger and is not a "purchase or sale" at all.

1. We are dealing with what is called the "no sale doctrine" and the interpretation of the 1934 Act in this re-

spect begins with the 1933 Act. Section 17 of the 1933 Act, 15 U.S.C. Sec. 77q, in various ways is directed at frauds in the sale of securities. The term "sale" is used also in Section 5 of the 1933 Act, 15 U.S.C. Sec. 77f, and in turn is defined in Commission Rule 133. It is thus Rule 133 and its antecedents which is the origin of the "no sale doctrine."

Rule 133 expressly excludes from the definition of "sale" a transaction where, in accordance with state law, a plan or agreement for a statutory merger or consolidation (a) is submitted to the vote of the stockholders; (b) where such a merger can be adopted only upon the vote of some established majority of the outstanding stock; and (c) where such a vote is binding on all stockholders except to the extent that dissenters may be entitled to receive the appraised or fair value of their holdings. Rule 133 could not cover more precisely an Arizona statutory merger—every item in the rule is also in the Code.

It follows that if Rule 133 as applied to the 1933 Act is equally applicable to Section 10 of the 1934 Act, then there could not conceivably be jurisdiction in the instant case because there is "no sale."

The Commission has been on both sides of this question in this Circuit:

(a) In *National Supply Co. v. Leland Stanford, Jr. University,* 134 F.2d 689 (9th Cir.), *cert. denied,* 320 U.S. 773 (1943), a stockholder brought an action under Sec. 12 of the 1933 Act for rescission in connection with stock issued as a result of a statutory merger or consolidation under Delaware law. At this time, Rule 133 was not in effect but an analogous antecedent rule was. The SEC brief in that case we deposited by photocopy with the District Court clerk; but its essential flavor will be shown by the following passages:

"But consolidations such as the one involved in this case and mergers under related provisions of law are not comparable to the various exchange situations just discussed. In such consolidations and mergers the alteration of the stockholder's security occurs not because he consents to an exchange, but because the corporation by authorized corporate action converts his security from one form to another. That is to say (as indicated by the Note to Rule 5), there is no sale where (1) the vote of the stockholders is effective (subject to directors' action and other statutory requirements) as corporate action and (2) this action binds all stockholders, assenters, dissenters, and non-voters alike (subject only to appraisal rights of dissenters). The essence of the Commission's construction, as expressed in the Note, is that in such cases a proposed corporate act is submitted to stockholders to be accepted or rejected by them as a class, in their capacity as members of the corporate body . . .

"A few examples will illustrate the difference between submission of a proposal for corporate action and an offer of exchange to stockholders as individuals:

(1) A proposal for merger or consolidation is submitted to the vote of the directors of a corporation before being submitted to the stockholders. Although the merger or consolidation, if consummated, will result in the directors getting different securities for those they held before the vote, we think it obvious that the submission of the proposal to them is not a "sale," because they act in their capacities as functionaries of the corporation, not as securityholders. The fact that they may hold securities which will be changed by the corporate action is immaterial, since the submission to them is not for the purpose of choice as individuals but as a step in the process of corporate action. We believe that subsequent submission of the same plan to those same directors as stockholders no more involves a sale than does the submission to them as directors. Both

directors' vote and stockholders' vote are necessary parts of the process of corporate action."

This Circuit Court of Appeals, noticing this brief, said:

". . . The Securities and Exchange Commission has filed an exclusive brief amicus curiae indicative of its view that the consolidation did not involve a 'sale' of securities, or an exchange amounting to a sale, hence the civil liability provisions of the Act have no application. Without going into the matter, we may say that we are in accord with the views of the Commission." 134 F.2d at 694.

(b) On the other hand the Commission took what seems to us to be the opposite point of view in *Sawyer v. Pioneer Mill Co., Ltd.,* 190 F.Supp. 21 (D. Hawaii 1960), *appeal dismissed for mootness,* 300 F.2d 200 (9th Cir. 1961), *cert. denied,* 371 U.S. 814 (1962). In *Sawyer,* an individual stockholder brought an action to enjoin a corporation from holding special stockholder meetings and from using certain proxy materials in effecting a corporate reorganization. In short, the private shareholder was seeking to enjoin essentially the same thing that the Commission is seeking to enjoin in the instant case, and it was doing so squarely on section 10(b) of the 1934 Act, the very same Act which is here involved. The Commission there argued that the "no sale rule" did not apply to the 1934 Act.

The District Court Judge, C. Nils Tavares, rejected this point of view and held flatly that there is no jurisdiction under Section 10(b) as to statutory mergers. The following findings of fact and conclusions of law are pertinent (190 F.Supp. at 23):

"8. That the solicitation of proxies by the defendants was for the purpose of effecting a corporate reorganization in accordance with the provisions of the Corporation Law of the State of Hawaii permitted by

Chapter 173, Revised Laws of Hawaii 1955, as amended, and not for the purpose of effecting a purchase or sale of any security.

"Conclusions of Law

*   *   *   *   *   *   *

"2. That the Court has no jurisdiction over the subject matter of this suit arising under the provisions of Section 10 of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78j as implemented by Rule X-10B-5 (17 C.F.R. § 240.10b-5)." *Id.* at 23.

2. The definitions of sale in the 1933 and the 1934 Acts were for all practical purposes identical.* We respectfully submit that on authority of the *Stanford* and *Sawyer* cases, we have a statutory merger, not a purchase or a sale, as those terms are used in Sec. 10(b). We cannot in this respect improve upon the argument made by the Commission in the *Stanford* case and we incorporate it by reference.

3. The weight of the cases in other circuits, we submit, supports the Ninth Circuit position. The SEC deals with this point at pages 22-28 of its opening brief. No case cited in its text supports their position even remotely; indeed, none is tendered as doing so. The few cases cited go to the rhetoric of the wholesome purposes of the SEC, but not one of them even purports to zero in on the question of the scope of Rule 10b-5. The matter is thus reserved to footnote 22, p. 28, of the Commission's brief, which is the compilation of relevant cases. They are as follows:

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*The principle is covered by the observation of Judge Bryan in *Barnett v. Anaconda Co.*, 238 F.Supp. 766, 774 (S.D.N.Y. 1965).

> "For all practical purposes both 17(a) [of the 1933 Act] and 10(b) [of the 1934 Act] with its implementing rule cover the same ground with one exception. Section 17(a) deals only with fraudulent practices 'in the offer or sale of any securities.' Section 10(b) through its implementing Rule 10b-5 deals with such practices in 'connection with the purchase or sale of any security.' " *Id.* at 774.

a. *Dasho v. The Susquehanna Corporation* (N.D. Ill., No. 65 C 1757, April 15, 1966, *rehearing denied,* June 28, 1966), *appeal pending,* (7th Cir.). The District Judge in this case held precisely as we contend here, that a statutory merger is not within the scope of this Rule at all. He said in his opinion of April 15, 1966:

> "We must conclude that the merger as stated in the complaint is not actionable under the fraudulent sale provisions of the Securities Acts. A statutory merger of the type with which we are concerned results in the automatic *involuntary* conversion of one type of security into another. That is, Susquehanna stock was not 'sold' for shares of Gypsum, but, rather, upon merger, the corporation converted shareholders' security from one form to another. This distinction was clearly upheld by the Ninth Circuit Court of Appeals in *National Supply Co. v. Leland Stanford Jr., University,* (9th Cir., 1943) 134 F.2d 689, at p. 694:
>
> " 'The Securities and Exchange Commission has filed an exhaustive brief *amicus curiae* indicative of its view that the consolidation did not involve a "sale" of securities, or an exchange amounting to a sale, hence the civil liability provisions of the Act have no application. Without going into the matter, we may say that we are in accord with the views of the Commission.' "

On motion for rehearing, the court enlarged its views. After discussing cases cited by the plaintiff purportedly opposed to his original opinion, the judge said:

> "In contrast, we find significant authority attesting to the correctness of our decision in the cases cited by defendants and referred to in our April 15 opinion.
>
> "In *National Supply Co. v. Leland Stanford Jr. Univ.,* (9th Cir., 1943) 134 F.2d 689, the Court held that no cause of action existed under Section 12(2) of the 1933 Act because the statutory 'consolidation did not involve a sale of securities or an exchange amount-

ing to a sale . . . ." While plaintiffs assert that the *Leland Stanford* case is limited, and that the definition of sale involved therein does not apply to Rule 10(b) 5 actions, we cannot agree. We must assume that the Court in the above case accepted the then official position of the S.E.C., as stated in its *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees,* Part vii, p. 249, f.n. 172 (1938), which report was transmitted over the signature of Mr. Justice Douglas, then Chairman of the S.E.C., and was prepared by named members of the Commission staff, including Mr. Justice Fortas. That report clearly stated, in part:

"'. . . it is essential to a "sale" under Section 2(3) [the definition provisions applying to the entire Act] that the prospective purchaser have the right individually and voluntarily to elect whether or not to purchase. In the case of the typical consolidation, merger, or sale of assets, this essential volition on the part of the individual shareholders is absent.'

"While it is apparent from the *amicus curiae* briefs submitted in the *Kuhn* case, referred to above, that the S.E.C., as an advocate, has changed its views, it is noteworthy that the Ninth Circuit Court of Appeals accepted the logic of its initial opinion, and that Congress, while aware of this attitude, and of the *Leland Stanford* decision, has not acted to alter the language of the section involved although it has had 23 years to do so, and, indeed, has enacted many other amendments during that period. While the S.E.C. may wish now to propose a new approach, it does so as an advocate alone, and we are certainly not bound to accept their arguments when we conclude that they are opposed to the logic of the only existing Court decisions in point, and to the intention of Congress as manifested by its inaction in this area. See *Safeway Stores v.*

Bowles, (U.S. Emergency Ct. of App., 1944), 145 F.2d 836, cert. den. 324 U.S. 847.

"In addition, we cannot accept plaintiffs' view that the Court in *Leland Stanford* merely adopted the 'no-sale' theory codified by the S.E.C. in Rule 133. Plaintiffs argue that under said rule, the issuance of stock upon a merger will not be considered a sale for registration purposes under Section 5, and that inasmuch as the rule specifically states that it does not apply to other sections of the Act, defendants cannot seek an exemption under Section 10(b). It is abundantly clear that the Ninth Circuit did not rely on Rule 133, as contended, inasmuch as *Leland Stanford* dealt with Section 12 only, and not Section 5."

This case is on appeal in the Seventh Circuit.

b. *Vine v. Beneficial Finance Co., Inc.,* 252 F.Supp. 212 (S.D.N.Y., 1966), *appeal pending,* (2d Cir.). *Vine* is conceded by the Commission to be contrary to its own position, but not quite so clearly as *Dasho.* Its holding is that a stockholder allegedly defrauded as a result of a New York short form merger is not a seller of securities within the ambit of the Securities Exchange Act, Section 10(b) and Rule 10b-5, since he did not accept an offer to sell his shares which was alleged as a preliminary step in the fraudulent scheme. Noting that the New York statute provides for the right to a fair appraisal and preserves the right to challenge the legality of the merger, the District Judge at page 215 said:

". . . no reason here exists for attempting to extend the purview of Section 10(b) of the Securities Exchange Act beyond the decisions of this circuit or in seeking to rationalize 'in connection with the purchase or sale of any security' to the situation here presented."

In *Vine,* appeal is also pending.

c. *Simon v. New Haven Board & Carton Co.,* 250 F.Supp. 297 (D. Conn. 1966). This is listed by the Commission as a decision which agrees with its position here. We don't know why. In *Simon,* the New Haven Railroad apparently (for the facts are not clear) issued stock pursuant to some authorization and used it to acquire another company which was merged with it. The District Court decision holds "that the corporate issuance of stock is a 'sale' within the meaning of the rule," 250 F.Supp. at 299. In the *Simon* case, the very fraud charged was that "the value of the stock issued" was "in excess of the consideration received," 250 F.Supp. at 298. In other words, in that case there was an actual bargain and sale for consideration; this is not in the statutory sense a merger at all.

d. *Voege v. American Sumatra Tobacco Corp.,* 241 F.Supp. 369 (D.Del. 1965). This case, too, is not in the real sense a merger. Here the plaintiff was called upon actually to sell her stock at a certain number of dollars a share. This was as a result of a merger but was a perfectly real sale, and this is the precise basis of the decision.

e. *Barnett v. Anaconda Co.,* 238 F.Supp. 766 (S.D.N.Y. 1965). This case is not a merger at all; it was a sale of assets for stock.

f. This leaves the very specific decision in *Sawyer v. Pioneer Mill Co. Ltd.,* cited and discussed earlier. This direct holding of a Ninth Circuit District Court is acknowledged by the Commission to be flatly against it.

Rule 10b-5 does not apply to this case because a statutory merger under the law of Arizona is not either in fact or in law a purchase or sale. Certainly, in this Circuit this kind of transaction has been recognized as not a purchase or sale since the *National Supply Company* decision in

1943. That decision, which the Commission now asks this Court to overrule, was reached at the behest and urging of the Commission itself 24 years ago. We can only say that this Court and the Commission were then right. No Circuit has disagreed. The only District Court cases which are truly squarely in point follow the principles of this Circuit's decision. There is no new light which calls for an overruling of the earlier decision. It should not be overruled.

V. Rule 10b-5 Does Not Deal with Proxy Solicitations.

The Securities Exchange Act of 1934 gives the Commission a mighty arsenal of weapons, and not all of them are in any one section or in any one rule. Rule 10b-5 deals with certain frauds in the purchase and sale of securities. The proxy section and the proxy rule are altogether different. It is Section 14 of the Act and Rule 14a-9 which deal with proxy solicitations. Section 14 of the Act, 15 U.S.C. Sec. 78n as it appeared prior to the 1964 amendments made it illegal in violation of the rules of the Commission to solicit proxies "in respect of any security . . . registered on any national securities exchange." These insurance companies were not registered on a national exchange, and therefore the Commission could not and did not attempt to assert jurisdiction of their proxy solicitations under the proxy rules.

Section 14 was extensively amended in 1964, 78 Stat. 569. The critical portion of the amendment is Section 12(g) of the Act, 15 U.S.C. Sec. 78*l*(g), extending the scope of the registration requirements to companies like these whose sales are over-the-counter. Under the previous law, Section 14 applied only to registered securities and excluded the over-the-counter variety. The amendment did not take

effect until 1966, so the companies of the sort here involved would not, in any circumstance, be subject to the Act until that time. But in addition there was an exemption for securities issued by insurance companies which were themselves subject to State regulations. These companies are in fact now subject to State regulations and therefore to this day they are not subject to Section 14 to this day.*

In these circumstances, the trial court recognized appellees' contention as made below. In the trial court, appellees contended as follows:

> "In the preceding section, we have argued that under Sec. 10(b), the statute does not reach statutory mergers. In this portion of the argument, we move to a new, alternative, but related position. That is that even if Sec. 10(b) did apply to mergers (which as we have argued it does not) it does not apply to proxy solicitations." (R. 216)

This point was developed more fully at R. 217-218. We again quote from our District Court brief:

> "In other words, the Commission is seeking to get a one year jump on the recent statute by doing now precisely what it will be authorized to do sometime after the middle of 1966 under the new Act. It seeks to do so by applying Sec. 10(b) to do the work of Sec. 14. We contend that Sec. 10(b) cannot be used for this purpose. The precise point was so decided by the Federal District Court in *Borak v. J. I. Case Company,* unreported in the District Court, 317 F.2d 838 (7th Cir. 1963), aff'd, *sub nom., J. I. Case Co. v. Borak,* 377 U.S. 426, 84 Sup. Ct. 1555 (1964). In *Borak,* a proxy solicitation had been made by allegedly false

*The present status of the matter depends upon events which occurred subsequent to the proceedings of the District Court and this therefore must be taken only as an avowal rather than as a record reference.

and misleading means. Plaintiffs sued in a private action under both Sec. 10(b) (as the Commission seeks to do here) and under Sec. 14 (as the Commission does not seek to do here). Judge Tehan whose unreported opinion we deposit with the Clerk, expressly rejected the 10(b) approach to the problem. He said:

'. . . The facts which plaintiff alleges as constituting a violation of § 10b, that is, the soliciting of proxies by means of a proxy statement containing false and misleading statements and omissions of fact, constitutes, if true, a violation of § 14a and not of § 10b. It is § 14a and not § 10b which protects "the stockholders" right to full and fair disclosure in corporate elections by proxy.' "

The treatment of the point in the higher courts is also considered in our District Court brief at R. 218.

We have taken the unusual step of quoting the District Court brief because it illuminates the ruling of Judge Mathes and it makes the more remarkable the treatment of this same matter by the Commission in this Court. In the light of the foregoing argument, Judge Mathes said:

"The acts complained of would fall within the prohibitions of the proxy-solicitation-anti-fraud provision of § 14 of the 1934 Act [15 U.S.C. § 78(n)], as implemented by Rule 14a-9 [17 CFR 240.14a-9], but for the fact that the stock of the insurance companies involved has never been registered on any national securities exchange;

"Not until sometime during 1966 will the coverage of § 14 be extended, by virtue of the act of August 20, 1964 [78 Stat. 569], to any corporation similarly situated to the insurance companies involved in this action; and then only if not exempted by new § 12(g)(2)(G) of the 1934 Act [15 U.S.C. § 78(1)(g)(2)(G)] which excludes "any security issued by an insurance

company" provided the insurance company is subject to certain defined State regulation; . . .

"Even if it be assumed that § 10(b) would otherwise be applicable to proxy solicitations [but see *Borak v. J. I. Case Co.,* unreported in the District Court, 317 F.2d 838, 846-847 (7th Cir. 1963), *aff'd on other grounds, sub nom. J. I. Case Co., v. Borak,* 377 U.S. 426 (1964);"

. . . going on to other grounds.

1. If the Findings and Conclusions of Judge Mathes may be regarded as an adjudication in our favor on the Section 14 argument, then the Commission has not met it at all. In its points on appeal, the subject is not touched (R. 820-21), and in its brief, it is not taken up. Appellees contend that this is an independent ground for the result, not challenged on appeal, and that on this ground apart from any other, the decision of the court should be affirmed or the appeal of the Commission should be dismissed.

2. Quite apart from the purely technical question just mentioned, we submit that Judge Tehan was right on the merits. As he said, "It is § 14a and not 10b which protects 'the stockholders' right to full and fair disclosure in corporate elections by proxy." See also *Barnett v. Anaconda,* 238 F.Supp. 766, 776 (S.D.N.Y. 1965), where the court stated:

"Moreover, in any event, there is no good reason why a claim based for all practical purposes solely on allegedly deceptive proxy material which is fatally defective for lack of causal connection under § 14(a) should be held to be good under § 10(b) and Rule 10b-5 or § 17(a). Section 14(a) is specifically designed to deal with deceptive proxy material and consequences flowing therefrom. There is nothing here to justify any contention that § 10(b) and Rule 10b-5 and

> § 17(a) provide enlarged or different remedies for what are merely violations of § 14(a)."

The 1964 amendments are expressly based on a special study by the Commission, as to which the relevant portion is House Doc. No. 95, pt. 3, pp. 40-41, 88th Cong. 1st Sess., in which the Commission dealt, among other things, with the need of coverage of insurance companies. In its discussion of proxy materials as they relate to insurance companies, the Commission expressly asserted that the proxy materials used in connection with such companies were inadequate by Commission standards. The Commission said:

> "In 15 instances, matters other than election of directors are to be voted on—*mergers,* options, retirement plans, etc.; there was not one solicitation which contained information approaching that required by the Commission proxy requirements." (Emphasis added.)

Again, in the statement made by SEC Chairman, William L. Cary, before the Senate Committee on Banking and Currency, various statements of the Commission itself were presented. One of these, a statement by the Commission staff relating to Sec. 14, expressly cited mergers as illustrative of the need for broadening the proxy controls; see *Federal Securities Law Reports*, CCH, No. 905, pt. 1, June 20, 1963, p. 89.

Why did the Commission tell the Congress that it needed to amend the Exchange Act to make the proxy rules applicable to mergers of over-the-counter companies if it already had that power under Section 10(b)? If, as it now contends, it has power under this subject matter under both sections, surely it was disingenuous not to have acknowledged it to the Congressional Committee.

We submit that Judge Tehan was absolutely right when he held that proxy solicitation is not a 10(b) matter.

VI. The Trial Court Committed No Error in Regard to the Purchase of Treasury Stock.

This case was presented to the trial court entirely in terms of the 1965 merger and the proxy solicitations in connection with it. But the SEC as an afterthought now contends that somehow the original purchase of treasury stock by National Securities from Producers in April, 1964, was a violation of Rule 10b-5. The complaint, R. 428, contains an allegation in connection with the Pound noncompete agreements that the defendants had some undisclosed intention not really to pay for the treasury stock which they purchased, but rather intended somehow to move this back, at least in part, on the seller, Producers.

1. The assignment of error relating to this subject is in the SEC brief, p. 10. Its precise language is as follows:

> "3. *The district court erred to the extent it may have suggested that the fraudulent statements made in connection with* the consolidation of Producers Life and National Life into National Producers and *the fraudulent omissions in the purchase of Producers Life treasury stock* were not 'in connection with the purchase or sale' of securities within the meaning of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder." (Emphasis added.)

This assignment of error itself clearly suggests that the District Court said something about alleged fraudulent omissions in the purchase of the treasury stock. But this is not so. The trial court did not say a word on this subject and suggested nothing at all. The sole express reference of the trial court to the purchase or sale problem refers solely and exclusively to the merger (R. 798)

and the error of "suggestion" which the Commission here charges simply never occurred at all.

This is because this entire point is a plain, unadulterated afterthought on the part of the Commission. It was not merely not "suggested" by the trial court; it was not "suggested" by the SEC either. Pretty clearly, the Commission seeks to rescue a bad situation here with the offer of arguments which it now wishes it had made but never did make in the court below.

This it may not do. All claims must be presented to the trial court and may not be presented for the first time on appeal unless they go to jurisdiction. See *Stephens v. Arrow Lumber Co.*, 354 F.2d 732 (9th Cir. 1966) (New contention regarding nature of contract not considered by appellate court). The rule is based upon sound policy considerations and, barring extraordinary circumstances, will be followed. *Partenweederei, M S Belgrano v. Weigel,* 313 F.2d 423, 425 (9th Cir. 1962), *cert. denied* 373 U.S. 904 (1964). Exceptions to this rule will be made only "to prevent manifest miscarriage of justice." *Thomason v. Klinger,* 349 F.2d 940 (9th Cir. 1965).

2. The SEC position is in any case without merit. The essence of the argument is that it is fraudulent to purchase stock in a company without disclosing an intention later to submit for approval of stockholders of that company a plan of reorganization one provision of which would excuse payment of part of the purchase price of the stock. This, it is asserted, is the fraud of nondisclosure. We are cited to such cases as *Errion v. Connell,* 236 F.2d 447 (9th Cir. 1956) and *List v. Fashion Park, Inc.,* 340 F.2d 457 (2d Cir. 1965), *cert. denied,* 382 U.S. 811 (1965). *Errion*, which seems to us immaterial, holds that Rule 10b-5 applies to fraud in the sale of stock plus the sale of

land; in other words, the mingled nature of the sale does not affect the application of Rule 10b-5. Why it is cited here, we must respectfully acknowledge, we do not know. *List* deals with insider fraud and the duty of corporate insiders to divulge to outsiders secret knowledge of their own concerning the corporation. But there is not even the thinnest kind of an allegation that the National Securities purchasers were "insiders" or had any fiduciary duty to Producers at the time of this purchase.

We have elsewhere pointed out that this was a nonexistent intention on April 27; but we realize that this is a factual matter which is not to be disputed on this motion. Yet the Commission, if it is to have the benefit of the fact that this matter is considered on the pleadings, must also take the liabilities. Paragraph 12 of the amended complaint (R. 430) expressly alleges that in all of the activities complained of (which would include this one) the selling directors were acting in concert with the defendants and in breach of their fiduciary duties. If so, then certainly the Commission cannot be heard to contend that there has been a failure of disclosure since the Commission here expressly alleges full knowledge on the part of the sellers acting as directors of Producers.

There is a larger point—the question of whether the selling directors breached their fiduciary duties by entering into the treasury stock transaction with National Securities. However, even if they did, *O'Neill v. Maytag*, 339 F.2d 764, 768 (2d Cir. 1964), concludes that a breach of general fiduciary duties owed by directors does not come within Rule 10b-5.

> "Our conclusion follows from our view of the purpose of § 10(b): '[T]hat section was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of

> securities rather than at fraudulent mismanagement of corporate affairs.' Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2 Cir.), cert. denied, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952)."

The court reached its conclusion contrary to the position taken by the Commission in that case and rejected as "broad dictum" language, *McClure v. Borne Chemical Co.,* 292 F.2d 824 (3d Cir. 1961), *cert. denied,* 368 U.S. 939 (1961), which is again relied upon by the Commission in its brief before this Court. In any case, if there has been a violation of Rule 10b-5 by the selling directors, they are no longer parties to the instant action as we have previously pointed out.

VII. The Claimed Remedy Is Not Within the Relief Available to the Commission.

The Commission originally brought this action to enjoin a merger. When this relief was denied and its temporary restraining order to this effect was quashed, the Commission took no further step to bar the merger. It did not, for example, apply to this Court for a stay pending appeal. The Commission, with emphatic insistence by Judge Mathes that this be done, was kept fully advised of the pending review of the matter by the Director of the Arizona Insurance Department in connection with his approval; indeed, the Commission submitted all of the information it had to the Director of the Arizona Insurance Department without, however, becoming a party. Hence, when the Arizona Director approved the merger the Commission was in no position to appeal as it might have done under Arizona law and apparently no other person was dissatisfied with the Director's order of approval, and no appeal was taken.

The question then arises whether the Commission may, after the event, attack the merger by demanding that it be undone. We contend that there is no jurisdiction under the 1934 Act to nullify a merger at the behest of the Commission once it has been accomplished. This was the view of the trial court (R. 800-01). The trial judge held that the relief sought is outside the scope of that provided in the relief section of the 1934 Act, Section 21(e), 15 U.S.C. Sec. 78u(e).

Appellees and the trial court were of course thoroughly familiar with *J. I. Case Co. v. Borak,* 377 U.S. 426, 84 Sup.Ct. 1555, 12 L.Ed.2d 423 (1964) which holds that there may be a retrospective remedy in suits by private persons brought under Section 27 of the 1934 Act, 15 U.S.C. Sec. 78aa. The *Borak* case did not purport to be brought under Section 21(e) of the same statute, 15 U.S.C. Sec. 78n(e) which expressly provides for the relief which the Commission as a plaintiff may obtain. That section provides that the Commission may get relief where a person "is engaged or about to engage" in illegal activities, and in such circumstances provides that an injunction or restraining order may be obtained. Not a syllable of that section suggests that the Commission may obtain relief where the action complained of is already an accomplished fact. Unlike the *Borak* case, the instant action is expressly based on Section 21(e); the complaint exactly and precisely says, "This action arises under Section 21(e) of the Act," R. 424.

Whatever general equities the Commission may be able to claim, if any, under *Borak,* did not see fit to claim them here. It rested solely and exclusively upon a statutory provision which in the clearest language conceivable is prospective only. It may not after the event switch to some wholly other claim of remedy, and the court below

correctly held that this remedy it not within the scope of Section 21(e). Not a single case cited by the Commission suggests, directly or indirectly, that a merger can be undone on the basis of any authority of Section 21(e), and we know of no such case.

In support of its contention that such retrospective relief may be granted to it, the Commission cites *Deckert v. Independence Shares Corp.,* 311 U.S. 282, 61 Sup.Ct. 229, 85 L.Ed. 189 (1940), and *Securities and Exchange Commission v. Los Angeles Trust Deed & Mortgage Exchange,* 285 F.2d 162 (9th Cir. 1960), *cert. denied,* 366 U.S. 919 (1961). In *Deckert* the Court granted rescission, the very relief provided for by Section 12(2) of the Securities Act of 1933, 15 U.S.C. Sec. 77*l*, under which the action was brought. In the *Los Angeles Trust Deed & Mortgage* case, this Court, recognizing it as the most difficult point in the appeal, upheld the appointment of a receiver, but only pendente lite until the registration provisions of the securities acts were complied with and as ancillary relief to the injunction issued. This Court specifically declined to permit the undoing of anything which had been done when it modified the District Court's order by striking authority for the receiver to accomplish liquidation and stated in its opinion at page 182:

> "It is appreciated that the conservator type of receivership which we have insisted upon is not well adapted to a business the very essence of which is promotion and, apparently, depends on a constant inflow of new business. However, a receiver does seem required. But, we are not yet willing to order liquidation. That would establish perhaps generally a special additional penalty for failure to comply with the two Acts of Congress with which we were here concerned and we doubt that this was within the contemplation of Congress."

CONCLUSION

It is respectfully submitted that the judgment of the court below should be affirmed.

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March, 1967.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

John P. Frank

(Appendix Follows)

Appendix

1. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j:

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

*   *   *   *   *   *   *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

2. Section 12(g)(1) of the Securities Exchange Act of 1934, 15 U.S.C. § 78*l*:

78*l* Registration requirements for securities

*   *   *   *   *   *   *

(g) (1) Every issuer which is engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce shall—

(A) within one hundred and twenty days after the last day of its first fiscal year ended after July 1, 1964, on which the issuer has total assets exceeding $1,000,000 and a class of equity security (other than an exempted security) held of record by seven hundred and fifty or more persons; and

(B) within one hundred and twenty days after the last day of its first fiscal year ended after two years from July 1, 1964, on which the issuer has total assets exceeding $1,000,000 and a class of equity security (other than an exempted security) held of record by five hundred or more but less than seven hundred and fifty persons,

register such security by filing with the Commission a registration statement (and such copies thereof as the Commission may require) with respect to such security containing such information and documents as the Commission may specify comparable to that which is required in an application to register a security pursuant to subsection (b) of this section. Each such registration statement shall become effective sixty days after filing with the Commission or within such shorter period as the Commission may direct. Until such registration statement becomes effective it shall not be deemed filed for the purposes of section 78r of this title. Any issuer may register any class of equity security not required to be registered by filing a registration statement pursuant to the provisions of this paragraph. The Commission is authorized to extend the date upon which any issuer or class of issuers is required to register a security pursuant to the provisions of this paragraph.

(2) The provision of this subsection shall not apply in respect of—

* * * * * * *

(G) any security issued by an insurance company if all of the following conditions are met:

(i) Such insurance company is required to and does file an annual statement with the Commissioner of Insurance (or other officer or agency performing a similar function) of its domiciliary State, and such annual statement conforms to that prescribed by the National Association of Insurance Commissioners or in the determination of such State commissioner, officer or agency substantially conforms to that so prescribed.

(ii) Such insurance company is subject to regulation by its domiciliary State of proxies, consents, or authorizations in respect of securities issued by such company and such regulation conforms to that prescribed by the National Association of Insurance Commissioners.

(iii) After July 1, 1966, the purchase and sales of securities issued by such insurance company by beneficial owners, directors, or officers of such company are subject to regulation (including reporting) by its domiciliary State substantially in the manner provided in section 78p of this title.

3. Section 14(a) of the Securities Exchange Act of 1934, U.S.C. § 78n:

§ 78n. Proxies

(a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy

or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title.

4. Section 21(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78u:

* * * * * * *

(e) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

5. McCarran-Ferguson Insurance Regulation Act, 15 U.S.C. § 1012:

§ 1012. Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided,* That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

5. Rule 10b-5 Promulgated Under the Securities Exchange Act of 1934, 17 CFR 240.10b-5:

§ 240.10b-5 Employment of manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

7. Rule 14a-9 Promulgated Under the Securities Exchange Act of 1934, 17 CFR 240.14a-9:

§ 240.14a-9 False or misleading statements

(a) No solicitation subject to §§ 240.14a-1 to 240.14a-10 shall be made by means of any proxy statement, form of proxy, notice of meeting, or other communication, written or oral containing any statement which at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

(b) The fact that a proxy statement, form of proxy or other soliciting material has been filed with or examined by the Commission shall not be deemed a finding by the Commission that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of or approved any statement contained therein or any matter to be acted upon by security holders. No representation contrary to the foregoing shall be made.

Note: The following are some examples of what, depending upon particular facts and circumstances, may be misleading within the meaning of this rule:

(a) Predictions as to specific future market values, earnings, or dividends.

(b) Material which directly or indirectly impugns character, integrity or personal

reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation.

(c) Failure to so identify a proxy statement, form of proxy and other soliciting material as to clearly distinguish it from the soliciting material of any other person or persons soliciting for the same meeting or subject matter.

(d) Claims made prior to a meeting regarding the results of a solicitation.

8. Arizona Insurance Code Provisions on Mergers:

§ 20-731. Merger or consolidation of stock insurers

A. A domestic stock insurer of any kind may merge or consolidate with another domestic or foreign stock insurer by complying with the provisions of general law governing the merger or consolidation of stock corporations formed for profit, but subject to subsection B of this section.

B. No such merger or consolidation shall be effectuated unless in advance thereof the plan and agreement therefor have been filed with and approved in writing by the director of insurance. The director shall give his approval within a reasonable time after filing unless he finds the plan or agreement:

1. Is contrary to law.

2. Inequitable to the stockholders of any domestic insurer involved.

3. Would substantially reduce the security of and service to be rendered to policyholders of the domestic insurer in this state or elsewhere.

C. If the director does not approve the plan or agreement he shall so notify the insurer in writing specifying his reasons therefor.

9. Arizona Corporate Code Provisions on Mergers:

ARTICLE 11. CONSOLIDATION OR MERGER

§ 10-341. Consolidation authorized

Two or more corporations may be consolidated, and continue as one of the constituent corporations or by forming a new corporation.

§ 10-342. Consolidation agreement

When two or more corporations desire to consolidate, a majority of the directors of each corporation affected may enter into an agreement setting forth the terms and conditions of the proposed consolidation, including:

1. Capitalization and number of shares of capital stock of the proposed consolidated corporation.

2. Classes into which the shares shall be divided and the value placed on each.

3. Manner of converting the shares and assets of the retiring corporations.

4. Whether one of the constituent corporations is to be continued or a new corporation formed.

5. Number of directors and officers.

6. Method of carrying into effect the terms of the agreement.

7. Other details necessary to disclose all matters affecting the consolidation.

§ 10-343. Notice of proposed consolidation

A. Notice of proposed consolidation of corporations shall be given by each corporation affected by publication in a newspaper published in the county in which its principal office is located, once each week for four successive weeks immediately prior to the meeting at which the proposed action is to be voted upon, and by mail to the last known address of each stockholder as shown by the books of the corporation, not less than thirty days prior to the meeting.

B. The notice shall contain:

1. The time and place of the meeting.
2. The value of the assets of the corporation.
3. The amount of its indebtedness.
4. A copy of the agreement of the boards of directors, as provided in § 10-342.

§ 10-344. Submission of agreement to shareholders

A. The agreement of the boards of directors to consolidate shall be submitted to the shareholders of each constituent corporation, who may vote in person or by proxy for the adoption or rejection thereof at either an annual or special stockholders' meeting.

B. If all outstanding shares in the corporation are of one class and of equal par value each share shall entitle the holder to one vote. If the shares are of different classes or of different par values, relative voting rights shall be upon such basis as the charter or by-laws of the corporation may provide, or in the absence of any express provision, then in the ratios of respective par values, treating each no par share, if any, as of a par value equal to the par value of

the outstanding shares of the corporation of highest par value.

C. If two thirds of the stock, valued as provided by this section, is voted in favor of consolidation, the agreement shall be declared adopted and the vote certified on the agreement by the secretary of the corporation so voting. The agreement shall be signed and acknowledged by the president and secretary of the corporation, and its seal affixed thereto.

§ 10-345. Formal requirements for consolidation

A. If an agreement for consolidation, ratified and certified by each constituent corporation as provided in § 10-344, provides that one of the constituent corporations shall be continued as the consolidated corporation, the certified agreement shall be filed in the office of the corporation commission, and one copy thereof, certified by the corporation commission, shall be recorded in the office of the county recorder of each county in which one of the constituent corporations has its principal office. The consolidation shall thereupon be deemed consummated and the separate existence of the constituent corporations to have ceased, and the consolidated corporation shall become a single corporation in accordance with the agreement, under its articles and name, possessing all powers and subject to all restrictions and disabilities of corporations organized for profit.

B. If an agreement for consolidation, ratified and certified by each constituent corporation as provided in § 10-344, provides for the formation of a new corporation, new articles of incorporation, reciting the consolidation and naming the constituent corporations,

shall be prepared and filed in the manner required by law.

§ 10-346. Transfer of assets and liabilities

All debts due to, and all property and assets of, each corporation consolidated as provided in this article shall vest in the consolidated corporation, but rights of creditors against and liens on the property of each corporation consolidated shall be preserved unimpaired. The debts, liabilities and duties of the corporations consolidated shall pass to the consolidated corporation, and may be enforced against it in the same manner and to the same extent as if incurred or contracted by, or imposed upon it.

§ 10-347. Payment for shares of dissenting shareholder; valuation

A. Any shareholder of the corporations consolidating who votes to reject the agreement, and who does not consent to the agreed manner of converting the shares of stock, shall be paid in cash the fair value of his stock, based on its pro rata share of the fair value of the net assets of the corporation of which he is a shareholder as of the time of the consolidation meeting. In the event of disagreement, such value shall be determined by the court in an action by either the dissenting shareholder or the corporation, and the corporation's existence shall be continued for that purpose.

B. Every shareholder shall be deemed to have consented to such method of conversion unless he gives written notice of dissent to the president, secretary or statutory agent of the corporation not later than

two days after the consolidation meeting, and unless he commences an action in the superior court of the county in which the principal office of the corporation is located to fix the value of his shares, not later than thirty days after such meeting. After the hearing the court shall determine the value of the dissenting stock, and the corporation shall pay the owner the sum so determined within thirty days after final judgment, whereupon the stock shall be transferred to the corporation.

§ 10-348. Consolidation or merger of domestic and foreign corporations

A. One or more domestic corporations and one or more foreign corporations may be merged or consolidated in the following manner, if the merger or consolidation is permitted by the laws of the state under which each foreign corporation is organized:

1. Each domestic corporation shall comply with the provisions of this article with respect to the merger or consolidation, as the case may be, of domestic corporations. Each foreign corporation shall comply with the applicable provisions of the laws of the state under which it is organized.

2. If the surviving or new corporation, as the case may be, is incorporated under the laws of another state, it shall comply with the provisions of article 17 of this chapter, if it is to transact any business in this state.

B. The surviving or new corporation may be either a foreign or domestic corporation, and when merged the surviving corporation shall be deemed to continue to exist under the laws of the state of its corporation.

§ 10-349. Effect of merger or consolidation; rights of shareholders

A. The provisions of this article, relative to the merger or consolidation of domestic corporations, shall apply to a domestic corporation which merges or consolidates with a foreign corporation or corporations. The effect of the merger or consolidation shall be the same as in the case of the merger or consolidation of domestic corporations except, if the surviving or new corporation is incorporated under the laws of another state, to the extent that the law of the other state otherwise provides.

B. The provisions of this article shall apply to the rights of shareholders of any one or more of the constituent corporations which are domestic corporations.

10. Arizona's "Little McCarran Act" provisions.

ARTICLE 6.

UNFAIR PRACTICES AND FRAUDS

§ 20-441. Purpose of article

Among the purposes of this article is the regulation of trade practices in the business of insurance in accordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945, 59 Stat. 33, by defining, or providing for the determination of, all such practices in this state which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined.

§ 20-442. Unfair trade practices prohibited

No person shall engage in this state in any trade practice which is prohibited by this article, or defined

in this article as, or determined pursuant to this article to be, an unfair method of competition or an unfair or deceptive act or practice in the business of insurance.

§ 20-443. Misrepresentations and false advertising of policies

No person shall make, issue or circulate, or cause to be made, issued or circulated, any estimate, illustration, circular, sales material or statement:

1. Misrepresenting the terms of any policy issued or to be issued or the benefits or advantages promised thereby or the dividends or share of the surplus to be received thereon.

2. Making any false or misleading statement as to the dividends or share of surplus previously paid on similar policies.

3. Making any misleading representation or any misrepresentation as to the financial condition of any insurer or as to the legal reserve system upon which any life insurer operates.

4. Using any name or title of any policy or class of policies misrepresenting the true nature thereof.

5. Making any misrepresentation to any policyholder for the purpose of inducing or tending to induce such policyholder to lapse, forfeit, surrender, retain or convert any insurance policy.

§ 20-444. False or deceptive advertising of insurance or status as insurer

A. No person shall make, publish, disseminate, circulate or place before the public, or cause, directly or indirectly, to be made, published, disseminated, circulated or placed before the public, in a newspaper,

magazine or other publication, or in the form of a notice, circular, pamphlet, letter or poster, or over any radio or television station, or in any other way, any advertisement, announcement, sales material or statement containing any assertion, representation or statement with respect to the business of insurance or with respect to any person in the conduct of his insurance business, which is untrue, deceptive or misleading.

B. No person that is not an insurer shall assume or use any name which deceptively infers or suggests that it is an insurer.

§ 20-445. Defamation

No person shall make, publish, disseminate or circulate, directly or indirectly, or aid, abet or encourage the making, publishing, disseminating or circulating of any oral or written statement or any pamphlet, circular, article, sales material or literature which is false or maliciously critical of or derogatory to the financial condition of an insurer, and which is calculated to injure any person engaged in the business of insurance, or any domestic corporation or group being formed pursuant to this code for the purpose of becoming an insurer. This provision shall not be deemed to restrict the right, lawfully exercised, of newspapers, magazines, radio and television stations, and similar public media for news dissemination, objectively to publish and disseminate news.

§ 20-446. Acts tending to result in unreasonable restraint or monopoly of insurance business

No person shall enter into any agreement to commit, or by any concerted action commit, any act of boy-

cott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the business of insurance.

§ 20-447. False financial statements or records

A. No person shall file with any public official, or make, publish, disseminate, circulate or deliver to any person, or place before the public, or cause, directly or indirectly, to be made, published, disseminated, circulated or delivered to any person, or placed before the public, any false statement of the financial condition of an insurer with intent to deceive.

B. No person shall make any false entry in any book, report or statement of any insurer or other person required to have records under this title, with intent to deceive any agent or examiner lawfully appointed to examine into its condition or into any of its affairs, or any public official to whom the insurer or person is required by law to report, or who has authority by law to examine into its condition or into any of its affairs, or, with like intent, wilfully omit to make a true entry of any material fact pertaining to the business of the insurer or person in any book, report or statement thereof.